Jowler Creek Vineyard and Winery: Uncorking Sustainable Growth in the Boutique Wine Industry

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Introduction

On a Saturday morning late this spring, Colleen and Jason Gerke, owners and operators of Jowler Creek Winery, could be found walking together through their vineyards toward their tasting facility. They were reflecting on how quickly the past year had flown by; their winery was officially three years old, their tasting room facility would soon be celebrating its first birthday, their newest wine “Butterfly Blush” was a 2008 award-winning wine, and they would soon be releasing their newest batch of Vignoles wine to retailers. While the Gerke’s were thrilled with the growth and success the winery had been achieving, they were also pensive; how could they continue to surpass the level of success they had, but maintain the winery’s focus on product quality and sustainability, especially given the tumultuous economic outlook and the ever changing regulatory environment of the United States wine industry ? Whatever the solution, they concluded, “We have to maintain the quality of our wines. We have to focus on getting the most flavor in every glass. And we have to do it in a way that is sustainable for the environment and for our family.”

Wineries in the United States

A Growing Commodity

The past 30 years have seen an explosion in wine consumption and the number of wineries in the United States. According to The Wine Institute (www.wineinstitute.org), U.S. wine consumption per capita increased from 1.98 gallons in 1979 to 2.47 gallons in 2008. Total U.S. wine consumption increased from 325 million to 753 million gallons over the same period. As a result, in 2008 the U.S. passed Italy to become the second largest wine market in the world, although per capita consumption in the US is still very low relative to other countries (not even in the top 50). Interest in wine extends well beyond the glass. The wine industry is a focal point for agritourism in the U.S. Acres of neatly trimmed vineyards, tours of wine production facilities, and visits to tasting rooms and a chance to learn first-hand from the wines' makers have turned into a thriving niche market for tourism in wine producing regions. A 2007 report by the wine research group MKF Research reported that the wine industry generated 27.5 million wine-related tourist visits annually, contributing $3 billion in wine tourism expenditures to the U.S. economy.

As interest in wine has increased, so has the number of wineries. The 1974 issue of Wines & Vines Annual Buyer's Guide listed 800 wineries operating in 34 states. The February 2009 issue of Wine Business Monthly (McKenney, 2009) reported just over 5000 bonded wineries in the US, with wineries located in all 50 states. Although the number of wineries has grown substantially, the vast majority of wine is produced by a relatively small number of large wineries. Wine Business Monthly reported that the 30 largest wineries in 2008 represent more than 90% of the US wine market by volume. The largest, E&J Gallo, produced 67 million cases (almost 160 million gallons) while the smallest of the top 30, Rutherford Wine Co., produced 380,000 cases (just over 900,000 gallons).

The Missouri Wine Industry

Missouri has a long tradition of wine production, going back to the early German settlers along the Missouri River in the mid-1800s. Prior to Prohibition, Missouri was the second largest wine producing state in the nation, producing over two million gallons annually. The industry was reborn in the 1960s, when several of the original wineries were restored and brought into production. Over the past 25 years, the number of wineries has grown from 25 to approximately 90 bonded wineries, and Missouri has four recognized American Viticultural Areas (AVA). In-state sales of Missouri wine have doubled in the past decade, growing from roughly 387,600 thousand gallons in 1998 to just over 837,000 gallons in 2007. This growth represents an increase in market share among Missouri wine consumers. Missouri wine market share increased from 5% in 1998 to over 7.5% of wine consumed in Missouri in 2007. As is the case nationally, production is highly concentrated among the largest producers, with just two wineries producing almost 54% of production by volume. Almost seventy percent of Missouri wineries produce less than 5,000 gallons; 22 wineries produce less than 1000 gallons each.

Wine also contributes significantly to Missouri's tourism industry. Research sponsored by the Missouri Wine & Grape Growers Association estimated there were 812,000 wine-related tourist visits in 2007, generating wine-related tourism expenditures of almost $203 million.

Legal Environment of Wine

The 21st Amendment, which repealed Prohibition, also granted states control of their own alcohol industries. Of the Amendment's three sections, the first repealed Prohibition, and is often most familiar to general consumers. The second, though, provided each state with the right to regulate its own alcohol beverage industry, and is the section most often considered by those producers and middlemen of the industry. The states' regulatory rights of control have been applied to all links of the supply chain and include the taxation and temperance rights. Although each state implemented their 21st Amendment regulatory rights differently, three distinct types of distribution systems emerged: state-operated distribution, private sector three-tiered distribution; and outright bans on alcohol. State-wide bans ended with Mississippi in 1966, leaving state-operated and three-tier distribution systems as the two forms observed today.

State-operated distribution systems involve state ownership of wholesale and, to some extent, retail alcohol sales, though some states opt to franchise operation of outlets at one or more levels to private contractors. States with state-controlled distribution systems are called control states or "monopoly states" and include Alabama, Idaho, Michigan, Mississippi, Montana, New Hampshire, North Carolina, Ohio, Oregon, Pennsylvania, Utah, Vermont, Virginia, Washington, and West Virginia.

Three-tiered distribution systems regulate the influence that parties at one stage of the value chain can exert on other stages by prohibiting integration between alcohol producers, wholesalers, and/or retails and by requiring retailers to make their purchases through licensed wholesalers and not directly from producers.[1] Most states operate a three-tier distribution system, requiring participants at each stage of the value chain to obtain operating licenses or permits issued by the state's Alcohol Beverage Control board ("ABC"). In addition to prohibiting integration, states also use the three-tiered system and permitting standards to implement other regulations including price posting, advertising, and restrictions on sites of sale and franchise laws.[2] The purpose of the three-tier system is argued as a means to limit producers' power to influence lower retail prices in order to increase quantity demanded, as increased demand presumably increases the occurrence of negative externalities associated with increased consumption.[3]

Although states require licensing and/or permit systems for firms in the industry, the number of producers and distributors has changed. As beer and wine have gradually become more popular the number of wineries and breweries have increased, especially the number of small wineries and microbreweries. The number of specialty brewers in the US increased from 37 in 1985 to 1552 in 2006, similar to the rate of growth in wineries described above. Growth has also been a trend in distribution; however it has been growth regarding firm size, not number of firms. Distributor consolidation in each alcohol segment in the last 20 years has led to a sizable reduction in the number of distributors per state, especially in the wine and spirits segments, and has led to an increase in the power of the national and regional distributors that have emerged. For example, the

[1] Some states allow producers to own interest in some kinds of distribution outlets, but the interest is not supposed to be controlling. California allows brewers to hold ownership interest in distribution outlets although this is prohibited in other states.

[2] There are a multitude of other regulations that states implement including standards on container sizes, production methods, and ingredient labeling. These regulations are standard legislation in other agricultural industries and are not unique to the three-tier distribution system.

[3] This reasoning is commonly cited in the literature for increased taxation and industry protection in each state although Reikhof and Sykuta (2005) show direct shipment laws were enacted for economic protection.

number of beer distributors has decreased from 4181 in 1985 to 2036 in 2006, while the number of wine distributors has decreased from 953 in 1983 and 733 in 2006.

These changes in industry structure have skewed market and contract power in favor of distributors and make it especially difficult for wineries to market to consumers. As most wineries are small, they are not able to produce large enough quantities that would make national (or even regional) distribution feasible. Additionally, as the ratio of distributors to wineries is very small, distributors effectively have a large pool of wine producers or brands from which to select. This bottleneck makes it very hard for wineries to secure a distribution agreement, and when they do, the terms are inherently in the distributor's favor.[4]

In addition to the bottleneck, distributors in some states receive an agreement advantage through state distributor franchise laws. These franchise laws are not about the typical franchising of businesses, but are regulations that provide protection to state's distributors, either through territory or termination provisions (or both). Franchise laws can include two provisions regarding distributor territory and/or termination, and it depends on the state if one, both, or neither are enacted. The territory provision gives a distributor a territorial monopoly over a brand when the producer first contracts with the distributor. The second provision is a termination provision; in most cases this means one of two things: a supplier must give at least 30-60 days notice to the distributor of intended termination or the supplier may only terminate on the basis of "good cause", which has been shown extremely hard to prove in court. Distributors, on the other hand, do not have substantial exit barriers to the distribution agreement. Distributors may formally terminate the agreement by notice or informally terminate the agreement as easily as not re-ordering supplier

[4] While distributor consolidation has also occurred in the industry's other segments, distribution of beer is less restrictive than that of wine or spirits which has allowed some breweries to take advantage of self-distribution and/or build distribution networks across regions. Distributor consolidation in the spirits industry has mirrored that of the wine industry, but as spirits distributors consolidated, so did spirits producers.

product. Existing franchise laws can make an already complex regulatory environment even more difficult for industry producers.

With the growth of the U.S. wine industry since the 1970s, states have sought ways to foster greater opportunities for industry development. Beginning with California in 1986, several states adopted laws allowing consumers to order wine from out-of-state producers and have it shipped directly to the consumer's home, thereby circumventing the three-tier system. States adopting direct shipment laws typically required reciprocal treatment of their own wineries as condition for direct shipment from other states. Some states adopted laws allowing intrastate direct shipment while prohibiting interstate direct shipments. Riekhof and Sykuta (2005) studied states' adoptions of interstate direct shipment laws and found states were less likely to adopt direct shipment when the state's wholesale distribution industry was more concentrated and when a greater percentage of the state's budget and staffing is dependent on alcohol-related licensing fees.

In 2005, the U.S. Supreme Court ruled in *Granholm v. Heald* that states must treat in-state and out-of-state wineries the same in their provisions for direct shipment. This ruling has spurred yet another wave of legislative activity as states attempt to comply. Thus far, there has been a move toward a limited form of direct shipment for intra- and interstate transactions. States that only allowed intrastate shipment have generally moved toward more open markets. States that formerly allowed reciprocal privileges with other states have adopted permitting systems that apply universally given concern about the discriminatory nature of reciprocal restrictions. To date, approximately 75% of states have adopted some form of direct shipment provisions, allowing wineries—particularly smaller wineries—the opportunity to reach near-national markets without dealing with traditional distributors.

Available Wine Distribution Channels

Alcohol industry regulation principally dictates that alcohol producers may not distribute their own products to downstream markets, but most states will slightly relax the distribution laws, depending on the type of product and/or size of the producer. Within the wine industry, many states recognize the distributor bottleneck that exists and have relaxed the marketing channel regulation to offer alternate distribution channels for producers. The specifics of these alternate channels are determined at the state level, but primarily include allowing smaller producers to sell directly through a winery sales force to retail outlets like grocery stores, specialty liquor stores, restaurants and also to traditional distributors; allowing producers with special licenses and facilities to sell directly minimal amounts through the winery's sales room or through mail or internet orders; allowing producers to sell indirectly through brokers (the winery has no sales force); and allowing producers to sell indirectly through a marketing company (Gooner, 2001).

These alternate channels, combined with the traditional distributor channel, offer wineries five distinct channels to distribute product. The traditional distribution channel, commonly referred to as the three-tier system of distribution, has historically been the only distribution channel for many producers. Table 1 breaks down revenue of US wine by channel, while Table 2 breaks down Missouri wines sales by channel (MKF Research, 2007a, 2007b). But Thach and Olsen (2006, 75) remark that "wineries' commitment to their relationship with [traditional] distributors appears to be more calculative than affective; in other words, the services provided by distributors are mandated but not necessarily desired". Although most channels are available in most states[5], wineries tend to choose one predominate distribution method.

[5] Some control states only have one channel as they regulate the sale of wine and act as that state's only distributor. Other states prohibit the direct shipment of wine to consumers.

Table 1: Revenue of US Wine by Channel, 2005

Total Winery Revenue of which:	$11,372,366,000
Estimated share through 3-tier system	$8,892,434,000
Estimated share through Self-Distribution and Direct-to Consumer	$1,772,565,000
Wholesaler Revenue	$2,667,730,000
Total Off-Premise Incremental Revenue	$4,979,763,000
Total On-Premise Incremental Revenue	$4,801,914,000
Total Sales of US Wine	**$23,821,773,000**

Source: MKF Research, 2007a

Table 2: Missouri Wine Sales by Channel, 2005

Total Winery Revenue	$28,485,000
Distributor	$10,616,000
Direct	$17,869,000
Distributor Income	$3,185,000
Retailer Income	$6,034,000
Restaurant Income	$5,389,000
Total Retail Value	**$43,093,000**

Source: MKF Research, 2007b

Jowler Creek Vineyard and Winery

History/Development of the Winery

Jowler Creek Winery is a "boutique vineyard and winery", and is one of the newest wineries in Missouri, having been established in 2006. Jowler Creek is a small winery, owned and operated by a husband and wife team, Jason and Colleen Gerke. Colleen, Jowler Creek's CEO, grew up in California's wine country and as a hobby studied viticulture and enology at California Polytechnic-San Luis Obispo, while Jason, the winery's COO, grew up in central Missouri and graduated from the University of Missouri with a degree in Agricultural Journalism. Although a young firm, the winery has had a productive history. Before their first batch of licensed wine was officially released in 2006, the winery was already invited to and winning awards at regional wine competitions. When they first released their wine in retail stores in the summer of 2007, the response from consumers was extremely positive and they were sold out of some wines by Christmas of the same year.

The Gerkes originally started making wine in their basement in 2001 as a hobby they both enjoyed. They had no notion to start a winery and originally planted the vineyards when they moved to their current location as a means to make wine strictly for their own consumption, and because they “thought the grapes would be pretty on the driveway”. In the spring of 2004 they planted 250 Norton grape vines, thinking that would be enough to “break a sweat”, and to learn about viticulture. Norton was a deliberate grape choice, because they had tried Missouri Norton wines[6] at other wineries and felt like Norton would be the easiest to grow. The couple reported the first year was spent learning about pest management, but the vineyards were very much still a hobby at that point.

In the fall of 2004 they prepped the soil and decided on the next year’s vines, adding more Norton and an acre of Vingoles vines. In the spring of 2005 they knew they would be able to market their grapes later on, and started thinking about agritourism – possibly having tourists come pick out their own grapes and make their own wine.

By the fall of 2006 the winery was bonded and licensed as a domestic winery. Because they knew that Kansas and Missouri had entirely different sets of distribution laws, it did not take them long to determine a “domestic wine permit” would be the best license for them; it would allow them to sell both retail and wholesale, the taxes paid would be on volume, and wholesale would offer the highest profit margin. Under the domestic winery license they were able to sell direct to consumers, which they remarked “was definitely a benefit (that was included) to Missouri wineries”. By the fall of 2007 their sales had grown so quickly that they had to apply for new licenses, a wholesaler/solicitor and a manufacturer/solicitor license. These licenses would allow them to

[6] Norton has been designated as the official grape of Missouri

purchase bulk wine to add to inventory, whereas the Missouri domestic wine license prohibited purchases of bulk wine.

Jowler Creek Production

The winery's focus is on product quality. "We plan to keep the focus on quality – from grape to glass," Colleen was quoted in the *Platte County Citizen*, "And when it's time to harvest we'll keep the emphasis on quality rather than quantity. Our goal is to truly get the most flavor in every glass" (2006). In order to achieve the quality they desire in the glass, Jowler Creek grows their own grapes. They currently have 3450 vines, growing four different grape varietals on five acres: Norton, Vignoles, Traminette, and Cabernet Franc. The first 250 grape vines were planted in the spring of 2004, 850 more were added in 2005, an additional 1900 in 2006, and the vineyard was planted to capacity with another 1100 vines in 2008. Of the available land for the four varietals, the Norton, Vignoles and Traminette grapes each cover 28.5% of the acreages, while the Cabernet Franc covers the remaining 14.5%. Currently, 75% of the juice they use to make wine comes from their own vines, with the remaining 25% from bulk purchases.

As grape vines can take at least three years to produce fruit, Jowler Creek's first batch of licensed wine, made from grapes in their vineyard, was not ready until 2006. That year the winery produced two different wines, and has added an additional five types in the last three years, although some are not made yearly. Table 3 shows the number of cases the winery has produced each year.

Jowler Creek is also devoted to sustainability in both the vineyard and in the winery. While the Gerkes enjoy growing grapes and making wine, they have an inherent respect for the environment and strive to maintain an ecological balance in their production practices. Table 4 provides a summary of their sustainable practices.

Table 3: Production of Jowler Creek Wines in Cases, 2006-2008

Wine		2006	2007	2008
Dry	Norton	120	240	440
	Chambourcin	0	40	50
Semi-Sweet	Traminette	0	35	30
	Vignoles	80	100	220
	*Critter Cuvee	0	50	100
	*Butterfly Blush	0	0	100
Sweet	Nort	0	50	0
	Premium Sweet Vignoles	0	20	0

Note: *year purchased and sold, versus year harvested

Table 4: Jowler Creek Sustainable Practices

Vineyard	Bat houses to naturally manage pests and maintain biodiversity in the vineyard's landscape
	Wildlife corridors around the vineyard to help preserve the natural environment
	Using sheep to graze weeds in vine rows
	Following integrated pest management disease models to reduce spraying applications
	No-till and cover crop management practices to reduce soil erosion
	Using solar power to electrify the fence surrounding the vineyard
Winery	Composting the pomace used from winemaking and using it as a natural fertilizer in the vineyard
	Recycling empty wine bottles used in the tasting room

Note: This table has been modified from the March 2009 Jowler Creek Grapevine Newsletter

Jowler Creek Distribution

Jowler Creek uses two distribution methods to sell their wine, direct to consumer sales and direct to retailer sales. They do not distribute through a traditional distributor, broker or marketer. Direct to consumer sales started in November 2006 through the winery's wine club, further developed in July 2008, when they added another direct to consumer sales venue through their vineyard tasting room and in June 2009, when they added direct online sales through http://www.americanwinery.com/jowlercreek. Their direct to retailer sales are focused on wine and liquor stores, not restaurants. Jowler Creeks' original projections were that 20% of their sales would come from direct retail (direct to consumers), while 80% would come through their wholesale sales (direct to retailers). With the opening of the tasting room they had projected that mix would change to 75% retail sales and 25% wholesale sales. A timeline of their direct to retailer sales locations is given in Table 5. Jowler Creek chose their original retail stores based on specific criteria: the stores had to have a customer base that goes into the store specifically to buy wine, it had to carry other local products (Missouri and Kansas wines), and the manager of the store had to be interested in carrying Missouri wines. Of the different distribution methods the winery employs, the highest selling venue for each of the eight wines offered occurs through the on-premise tasting room.

Their biggest concern in adding additional retailers is that they do not expand beyond their ability to maintain product on the shelf, in terms of both volume of production and ability to physically deliver product. The Gerke's are still learning about the logistics of having to deliver all of their products to the retailers in a timely manner.

Table 5: Timeline of Jowler Creek Direct to Retailer Locations

Retailer	Location	Date started supplying
Cellar Rat Wine Merchants	Kansas City, MO	8/9/2007
Gomer's Fine Wine and Spirits	Parkville, MO	8/9/2007
Lukas Liquor Superstore	Kansas City, MO	7/28/07
Olive-or-Twist Liquor	Platte City, MO	6/15/07
Platte City Cash Saver	Platte City, MO	7/23/07
Rimann Liquor	Kansas City, MO	7/28/07
The Saint George Hotel Wine Bank	Weston, MO	7/28/07
Vino 100	Kansas City, MO	8/13/07
Willow Springs Mercantile	Excelsior Springs, MO	10/11/07
Wines by Jennifer	Parkville, MO	8/14/07
Green Acres Market	Kansas City MO	2/08
Heavenly Scent	Platte City, MO	2/08
Hyvee	Belton, MO	9/08
Hyvee	St. Joseph, MO	2/09
Red X	Kansas City, MO	11/08
The Wine Cellar	Kansas City, MO	9/08
Wines and More	Sedalia, MO	2/09
Hyvee	Lee's Summitt	5/09

Note: This table shows the timeline of Jowler Creek's addition of direct to retailer locations, from the beginning of the winery's formation to the present.

Each of the distribution methods has been successful for Jowler Creek. While they originally estimated 2008 would be the first year they turned a profit, they actually started turning a profit in 2007. The winery estimates an average gross margin of 65% for wines that are sold direct to consumers, and average gross margin of 53% for wines that are sold direct to retailers. Table 6 provides estimates of summary financial indicators for the winery's production and distribution.

Table 6: Estimated Summary Statistics

	Wine	2009 Retail Price/bottle	Gross Margin[7] (DTC)	Gross Margin (DTR)
Dry	Norton	19.00	63%	51%
	Chambourcin	19.00	na	na
Semi-Sweet	Traminette	15.00	70%	60%
	Vignoles	15.00	65%	53%
	Critter Cuvee	13.00	na	na
	Butterfly Blush	13.00	na	na
Sweet	Nort	15.00	61%	48%
	Premium Sweet Vignoles	13.00	70%	60%

Conclusion

The goal of the winery has been cited to be self-sustaining, and the Gerke's keep that vision in mind with regards to their distribution channel, "We're never gonna compete with the big guys (in the state); we want to stay on the boutique side," Jason has said (Chapin 2007). The couple mentioned that even if they wanted to, right now they do not have enough volume to sell through a traditional distributor, although they commented if the winery one day had the volume, traditional distributors could provide a service to more efficiently move wine around.

What strategies can this small winery use to grow in these economically troubling times, while still maintaining the sustainable production values and boutique quality wine they are known for?

[7] Cost of Goods Sold used to figure Gross Margin (both DTC and DTR) includes all costs to bottle the wine.

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